

## Quarter insights

- Equity markets enjoyed a strong start to the year, driven by robust corporate earnings reports and supportive comments from global central banks. The stock market rally was broader and less driven by the so called “Magnificent Seven” large US technology stocks.
- US economic growth remains resilient, helped by unusually high Government spending. Elsewhere growth is slower, as the UK joined the list of advanced economies experiencing a technical recession during the second half of 2023.
- The Swiss National Bank unexpectedly cut rates by 0.25% as inflation fell close to 1%. All other major developed central banks held off cutting interest rates. US Federal Reserve Chairman Jerome Powell reiterated in March that he expects 0.75% of rate cuts during the rest of 2024.
- It was a more challenging environment for fixed income investors as mixed inflation data forced markets to price in less interest rate cuts than were expected at the start of the year.
- The UK chancellor Jeremy Hunt delivered his Spring Budget, which included a 2p cut to National Insurance.

## Market review

Equity markets ended 2023 on a high note following Fed Chairman Jerome Powell's dovish 'pivot' in December, which raised hopes of significant interest rate cuts. The rally for equities has continued into 2024, despite the likelihood of fewer cuts than were expected at the start of the year. The explanation for this is the strong global economy, particularly in the US. Investors are translating this into better prospects for corporate earnings growth.

*The global economy continues to evade the recession that many analysts were predicting.*

Despite this, the purchasing manager indexes compiled by S&P Global show that the global economy has recently moved back into expansion mode.

Both the US and Chinese manufacturing sectors are contributing to the strength, although Europe continues to lag. The bond yield curve remains inverted, a condition where longer-term bonds yield less than short-term ones, reflecting the market's continued expectation of a recession.

Cyclical stocks, that tend to do well in an economic growth cycle, outperformed defensives stocks in Q1. The S&P 500, which is the bellwether for US equities, enjoyed a strong quarter. Its current run without a pullback of even as little as 2% now stretches to five months. It is notable that the performance continues to broaden out and is less focussed on the “Magnificent Seven” large

technology names. Japanese equities continue to do well, with the Nikkei 225 Index posting its first all-time high for nearly 30 years. UK equities lagged behind, but finished with a strong March performance. An index of 100 leading UK stocks ended the quarter up with a close to 4% total return.

The strong global economy and jobs market, as well as relatively sticky inflation prints, did cause a weaker performance for government bonds. With fewer rate cuts being expected, the relative attractiveness of bonds has reduced in the short term.

*Credit spreads, which measure the extra yield that investors require to take the extra risk of lending to a company rather than the government are as low as they have been in a quarter of a century. This meant that bonds issued by companies did a little better, a further sign of risk appetite during the quarter.*

Elsewhere, commodity prices were broadly strong. US crude oil futures surged to \$85 a barrel for the first time since October. Cocoa prices rose above \$10,000 per tonne for the first time ever, more than doubling in two months, due to poor harvests in Africa. Despite generally being regarded as a safe haven asset, the price of gold also continued to climb higher, exceeding \$2,200 per troy ounce for the first time.

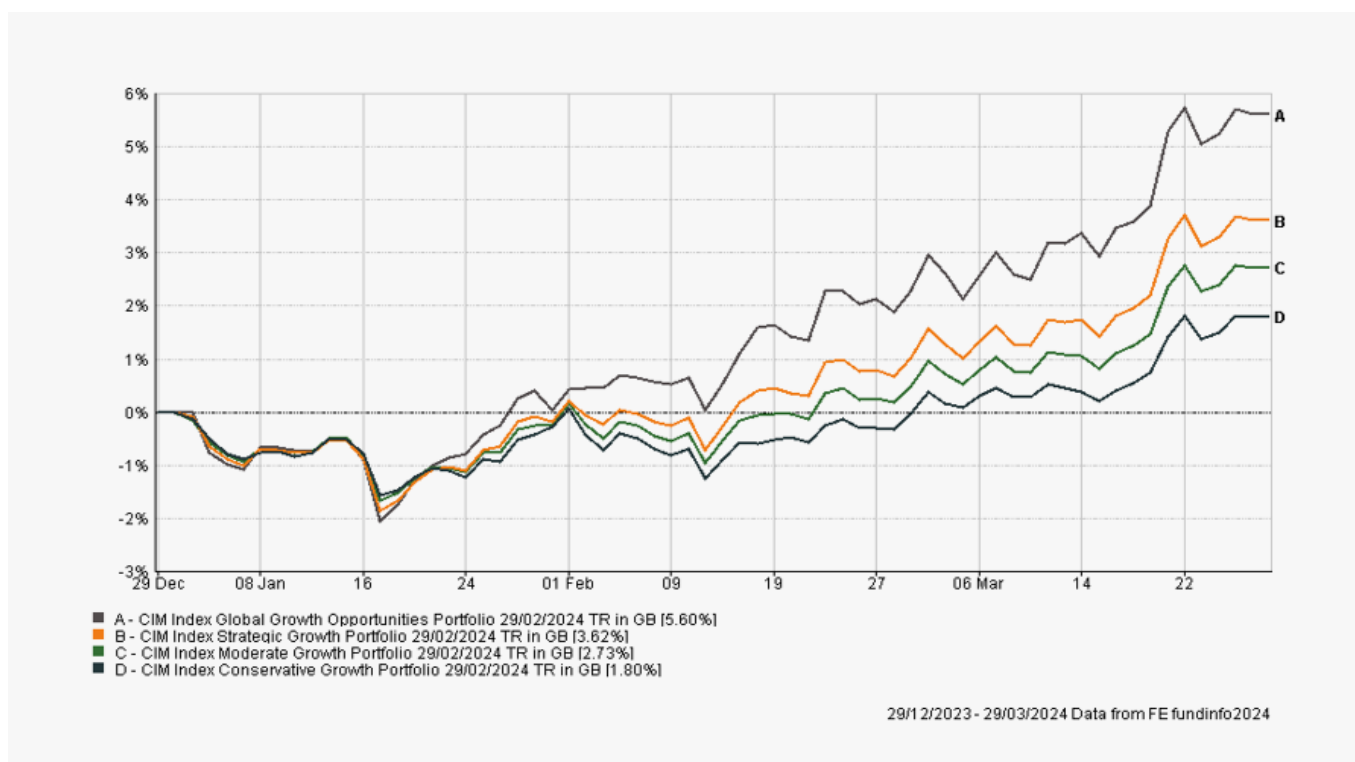
## Index portfolios performance

Index Portfolios	3 months
CIM Conservative Index Portfolio	1.80%
ARC Sterling Cautious PCI	1.90%
CIM Moderate Index Portfolio	2.73%
ARC Sterling Balanced Asset PCI	3.01%
CIM Strategic Index Portfolio	3.62%
ARC Sterling Steady Growth PCI	4.03%
CIM Global Index Opportunities Portfolio	5.60%
ARC Sterling Equity Risk PCI	4.96%

Index Returns <sup>1</sup>	3 months
UK Equities	3.96%
UK Government Bonds (Gilts)	-1.63%
All Country World Equities	9.09%
Pacific Equities (ex Japan)	-0.86%
Emerging Market Equities	2.88%
US Equities	11.49%
UK Headline Inflation	0.46%

Past performance is not a reliable indicator of future performance; and the value of investments, as well as the income from them can go down as well as up, and investors may get back less than the original amount invested.

## Performance graph



## Key Funds and Trades over the Quarter

Top 3 Model Funds	3 months
Amundi Prime Japan ETF	12.34% ▲
Vanguard S&P 500 ETF	11.49% ▲
Amundi Prime Global ETF	9.81% ▲

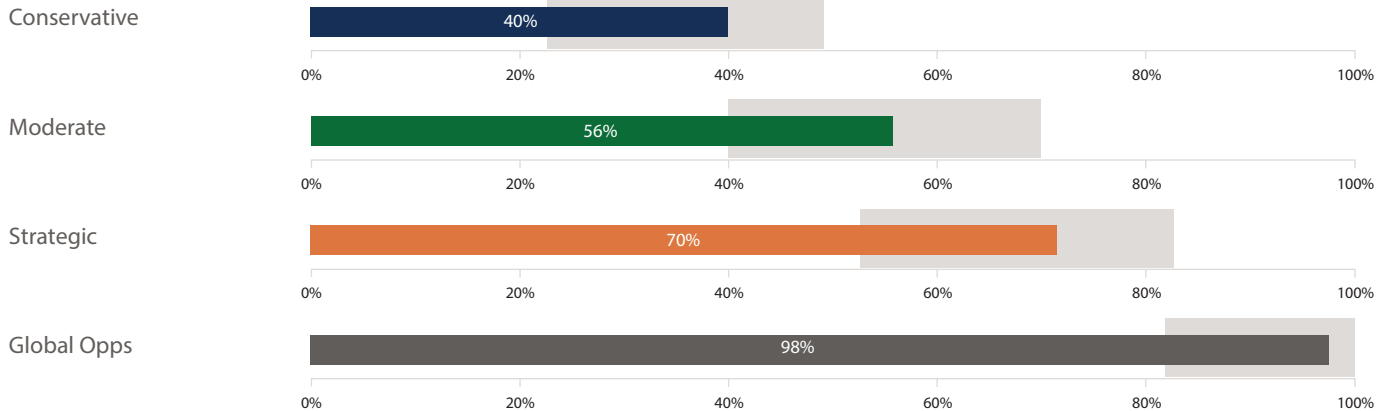
Bottom 3 Model Funds	3 months
Amundi Index Global Agg ETF	-0.35% ▼
iShares \$ Treasury Bond 3-7yr ETF	-0.70% ▼
Lyxor Core UK Government Bond ETF	-1.63% ▼

Source FE Analytics to 31st March 2024

Key fund	Commentary
Amundi Prime Japan ETF	We increased the allocation to this ETF during the quarter. It offers broad exposure to Japanese equities. Stocks in Japan are benefitting from a number of tailwinds, including a weak currency (helping exports), corporate governance reforms enacted by the Tokyo Stock Exchange, the Bank of Japan's accommodative policy stance, and renewed buying among overseas investors.
Vanguard S&P 500 ETF	This ETF holds the 500 largest publicly traded stocks in the US, which in aggregate are starting to increase earnings following a couple of years of flat earnings growth. We funded the investment by switching out of a similar fund, but which hedged out the currency exposure of the US Dollar. This benefitted the investment as the Dollar fell during the period it was held, but we are now more comfortable having the dollar exposure.
Amundi Prime Global ETF	We have added this ETF as a core allocation within the portfolio. It tracks an index from Solactive that covers global developed market large and mid sized companies. The weighting of each stock held is proportionate to the size of the company within the Index. It is very modestly priced, with an annual Ongoing Charges Figure of only 0.05%.
Lyxor Core US TIPS ETF	We added a holding of this ETF, which offers exposure to the US Treasury Inflation Protected Securities (TIPS) market. These are bonds issued by the US government and are designed to help protect against inflation as the bond coupons and principal are linked to the Consumer Price Index. They will help to protect the purchasing power of the portfolio and currently offer a yield of c. 2% above inflation.

## Asset class review

### Equity Exposure



### Conservative

#### Ten largest fund holdings (%)

Lyxor Core US TIPS (DR) UCITS ETF	14.0%
Lyxor Core FTSE Actuaries UK Gilts 0-5Y	12.8%
Amundi Index Global Agg Hedged ETF	11.2%
iShares Global Corp Bond UCITS ETF	10.2%
iShares Glb HY Corp Bond Hdged	9.8%
Lyxor Core UK Equity All Cap ETF	8.0%
Vanguard S&P 500 UCITS ETF	7.5%
Amundi IS Prime Japan ETF	6.8%
Amundi Prime Global ETF	6.6%
HSBC European Index	5.6%
Assets in top ten holdings	92.5%

#### Ten largest asset class exposures (%)

Government Bonds	20.6%
Index-Linked Bonds	14.0%
Corporate Bonds	13.6%
North American Equities	12.1%
High Yield Bonds	9.8%
UK Equities	8.4%
Japan Equities	7.3%
European Equities	6.6%
Asia Pacific ex Japan Equities	4.2%
Cash	2.0%

### Moderate

#### Ten largest fund holdings (%)

Lyxor Core US TIPS (DR) UCITS ETF	12.0%
Lyxor Core UK Equity All Cap ETF	11.2%
Vanguard S&P 500 UCITS ETF	10.4%
Amundi IS Prime Japan ETF	9.6%
Amundi Prime Global ETF	9.2%
iShares Global Corp Bond UCITS ETF	8.2%
HSBC European Index	7.9%
iShares Glb HY Corp Bond Hdged	7.8%
HSBC MSCI Emerging Markets ETF	7.7%
Lyxor Core FTSE Actuaries UK Gilts 0-5Y	7.5%
Assets in top ten holdings	91.5%

#### Ten largest asset class exposures (%)

North American Equities	17.0%
Government Bonds	12.0%
Index-Linked Bonds	12.0%
UK Equities	11.7%
Japan Equities	10.2%
Corporate Bonds	10.1%
European Equities	9.2%
High Yield Bonds	7.8%
Asia Pacific ex Japan Equities	5.9%
Cash	2.0%

Cash includes cash held in underlying funds plus GBP held in model.

## Asset class review

### Strategic

#### Ten largest fund holdings (%)

Lyxor Core UK Equity All Cap ETF	14.1%
Vanguard S&P 500 UCITS ETF	13.0%
Amundi IS Prime Japan ETF	11.9%
Amundi Prime Global ETF	11.5%
Lyxor Core US TIPS (DR) UCITS ETF	10.0%
HSBC European Index	9.8%
HSBC MSCI Emerging Markets ETF	9.6%
iShares Global Corp Bond UCITS ETF	5.1%
iShares Glb HY Corp Bond Hdged	4.9%
Lyxor Core FTSE Actuaries UK Gilts 0-5Y	4.3%
<b>Assets in top ten holdings</b>	<b>94.3%</b>

### Global Opps

#### Ten largest fund holdings (%)

Lyxor Core UK Equity All Cap ETF	19.7%
Vanguard S&P 500 UCITS ETF	18.3%
Amundi IS Prime Japan ETF	16.7%
Amundi Prime Global ETF	16.2%
HSBC European Index	13.8%
HSBC MSCI Emerging Markets ETF	13.5%
<b>Assets in top ten holdings</b>	<b>98.0%</b>

#### Ten largest asset class exposures (%)

North American Equities	21.2%
UK Equities	14.6%
Japan Equities	12.7%
European Equities	11.5%
Index-Linked Bonds	10.0%
Asia Pacific ex Japan Equities	7.4%
Government Bonds	6.9%
Corporate Bonds	6.2%
High Yield Bonds	4.9%
Emerging Market Equities	2.5%

Cash includes cash held in underlying funds plus GBP held in model.

#### Ten largest asset class exposures (%)

North American Equities	29.7%
UK Equities	20.5%
Japan Equities	17.9%
European Equities	16.2%
Asia Pacific ex Japan Equities	10.3%
Emerging Market Equities	3.5%
Cash	2.0%

Cash includes cash held in underlying funds plus GBP held in model.

Asset Class	Portfolio Views
Fixed Interest	Bonds faced a headwind during Q1 from rising yields, as expectations of rate cuts were pushed back, although higher-risk bonds outperformed. Fixed income markets are now more fairly priced, and we expect them to protect well against a growth shock. With inflation not yet beaten we are wary of increasing duration too high.
UK Equity	UK equities underperformed most other equity markets during the first quarter against a backdrop of the poor performance of the UK economy, which fell into a technical recession at the end of 2023. The market is now looking very undervalued, especially smaller UK companies and there were signs at the end of the quarter that the tide of performance is beginning to turn.
US Equity	US equities continued the recent trend of outperformance, helped by strong earnings growth and a resilient economy. The larger stocks are now looking very overvalued, so we are favouring companies that have stronger fundamentals, with higher dividend yields. We expect a continued catchup in their performance.
Japan Equity	We continue to overweight Japanese equities, which again performed well in Q1. The region is now firmly back on the radar of international investors and enjoying inflows. Earnings are growing strongly, yet the market overall remains quite modestly valued.
Asia and Emerging Market Equity	Asian and EM as a whole underperformed during Q1. China did recover somewhat on the back of better economic activity and some easing measures from the People's Bank of China. We view the region as undervalued and favour companies that are cheap compared to their fundamentals (earnings etc). We are not yet overweight.
Alternatives	We favour an investment allocation to equity market-neutral funds, which seek to exploit risk premiums like the 'value' investing approach. The trades are usually executed with a relative-value strategy, resulting in surplus cash that is currently generating significant additional income due to elevated interest rates.

## Outlook

The current market narrative is that inflation is being brought under control without causing an economic slowdown, which has been described in the financial media as a “no landing” scenario.

*However, historically when inflation reaches the highs that it did in 2022, it is the last mile back to 2% which is the most difficult, and there has been several spikes higher before the target is achieved.*

The Fed’s preferred inflation indicator is the core personal consumption expenditures price index, which strips out the volatile food and energy components. This jumped higher on a month-over-month basis in January and February. The recent uptrend in many commodity prices is a further reminder that inflation may not yet be completely under control and is something we will be watching closely during the second quarter.

Interest rates are currently appreciably above the rate of inflation. Historically, when real (inflation-adjusted) rates are high, growth

eventually slows as it represents a tightening of financial conditions. Part of the reason that growth hasn’t slowed so far is due to the strength of the consumer, which is supported by the fact that most people who want a job have one. If unemployment does pick up, it will likely impact on consumer spending.

Coming into 2024, bonds were pricing in more rate cuts than were being indicated by central bankers. The fall in bond prices since then means that the two are now much more closely aligned. We believe if the global economy does show signs of weakening, it would likely be met with more aggressive rate cuts than are currently being priced in.

*This should be very positive for the performance of bonds and parts of the equity market that have a bond-like profile, meaning defensive stocks that generate a stable income.*

We see a potential asymmetric risk/reward profile for these types of assets, given that the market appears to be positioned for the opposite scenario.

## Thoughts for the quarter ahead...



- The market narrative that inflation is being brought under control without causing a significant economic slowdown will be tested if commodity prices, particularly crude oil, continue rising. We are watching this closely.
- Markets are expecting the US Federal Reserve and Bank of England to start cutting interest rates during the second quarter. We believe this will be key for asset prices going forward.
- We are currently avoiding markets that we view as overvalued, such as large US technology companies, and are positioned for a continued catch-up from more fairly priced equities. We are favouring lower volatility stocks that have an attractive dividend yield.
- The US quarterly earnings season covering Q4 2023 was positive, and all eyes will be on companies when they start reporting on Q1 2024. Nvidia results will be particularly influential.
- Geopolitical risks remain elevated, with conflicts being fought in several geographic regions.
- The build-up to national elections in many countries will gather steam during Q2. This could influence many investment markets in the short term.

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<sup>1</sup>For the comparative index returns, we have used the total return performances of the following ETF's:

Comparative Index	ETF Name
UK Equities	ISHARES CORE FTSE 100
US Equities	ISHARES CORE S&P 500
European Equities (ex UK)	ISHARES MSCI EUROPE EX-UK
Emerging Market Equities	ISHARES CORE EM IMI ACC
Japanese Equities	ISHARES CORE MSCI JAPAN
Pacific Equities (ex Japan)	ISHARES CORE MSCI PACIF X-JP
UK Government Bonds (Gilts)	SHARES CORE UK GILTS
Global Bonds (GBP hedged)	ISHARES CORE GLB AGG GBP-H D
Commodities	ISH DIVERS COMMOD SWAP ETF